Internal Revenue Service

Department of the Treasury

Washington, DC 20224

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Person to Contact:

Telephone Number:

Refer Reply to:
CC:EBEO:1 PLR-103332-98

Date:
SEP 28 1998

X

Plan

Trust =

Dear

This is in response to your request for a ruling dated December 27, 1997, on behalf of X concerning a nonqualified deferred compensation agreements (the "Plan") and a trust agreement (the "Trust") established to provide benefits for designated key management employees (the "Participants") of X and any subsidiary or other affiliate of X who adopts the Plan.

X represents that the Plan constitutes an unfunded, nonqualified deferred compensation plan that benefits certain designated employees who are within a select group of key management or highly compensated employees. It is also represented that the obligation of X, or any affiliate of X that adopts the Plan, to pay benefits under the Plan constitutes a mere promise to pay Plan benefits and that any participant or beneficiary will remain no more than an unsecured general creditor of X or the adopting affiliate.

X established the Plan to allow Participants to realize the retirement benefits they otherwise would to able to attain under the qualified cash or deferred profit-sharing plan (the "qualified plan") of X but for the limits on contributions and benefits applicable to the qualified plan under the Internal Revenue Code of 1986. The Plan provides for payment of benefits upon termination of employment.

The right of a participant or his beneficiary to receive payments under the Plan may not be anticipated, alienated, sold, assigned, transferred, pledged, encumbered, attached or garnished by creditors of such Participant or beneficiary.

X established the Trust to hold assets to provide X and any adopting affiliate with a source of funds to pay obligations to the Participants under the Plan. The trustee will establish separate bookkeeping accounts to account for the contributions of X and any adopting affiliates. The assets held by the Trust in the account of any individual employer will be subject to the claims of the general creditors of the individual employer, but will not be subject to the claims of the general creditors of any other employer having assets held by the Trust. The Trust conforms to the model trust contained in Revenue Procedure 92-64, including the order in which the sections of the model trust language appear. The Trust does not contain any language that is inconsistent with, or conflicts with, the language of the model trust agreement.

Under the Plan and the Trust, the interest of a Participant (or beneficiary) in the trust estate shall be no greater than the interest of any general unsecured creditor of X.

Section 83(a) of the Internal Revenue Code provides that the excess (if any) of the fair market value of property transferred in connection with the performance of services over the amount paid (if any) for the property is includible in the gross income of the person who performed the services for the first taxable year in which the property becomes transferable or is not subject to a substantial risk of forfeiture.

Section 1.83-3(e) of the Income Tax Regulations provides that for purposes of section 83 the term "property" includes real and personal property other than money or an unfunded and unsecured promise to pay money or property in the future. Property also includes a beneficial interest in assets (including money) transferred or set aside from claims of the transferor's creditors, for example, in a trust or escrow account.

Section 402(b) of the Code provides that contributions made by an employer to an employees' trust that is not exempt from tax under section 501(a) are included in the employee's gross income in accordance with section 83, except that the value of the employee's interest in the trust will be substituted for the fair market value of the property in applying section 83. Section 1.402(b)-1(a) (1) of the regulations provides that employer contributions to a nonexempt employees' trust are included as compensation in an employee's gross income for the taxable year in which the contribution is made, but only to the extent that the employee's interest in such contribution is substantially vested, as defined in the regulations under section 83.

Section 404(a) (5) of the Code provides the general deduction timing rules applicable to any plan or arrangement for the deferral of compensation, regardless of the Code section under which the amount might otherwise be deductible. Pursuant to section 404(a) (5) of the Code and section 1.404(a)-12(b) (2) of the regulations, and provided that they otherwise meet the requirements for deductibility, amounts of contributions or compensation deferred under a non-qualified plan or arrangement are deductible in the taxable year in which they are paid or made available, whichever is earlier.

Section 451(a) of the Code provides that the amount of any item of gross income shall be included in gross income for the taxable year in which the taxpayer receives it, unless, under the method of accounting used in computing taxable income, such amount is to be properly accounted for in a different period. Section 1.451-1(a) of the regulations provides that under the cash receipts and disbursements method of accounting, amounts are included in gross income when actually or constructively received.

Section 1.451-2(a) of the regulations provides that income is constructively received in the taxable year during which it is credited to the taxpayer's account or set apart for him or otherwise made available so that he may draw upon it at any time, or so that he could have drawn upon it during the taxable year if notice of intention to withdraw had been given. However, income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions.

Under the economic benefit doctrine, an employee has currently includible income from an economic or financial benefit received as compensation, though not in cash form. Economic benefit applies when assets are unconditionally and irrevocably paid into a fund or trust to be used for the employee's sole benefit. Sproull v. Commissioner, 16 T.C. 244 (1951), aff'd per curiam, 194 F.2d 541 (6th Cir. 1952); Rev. Rul. 60-31, Situation 4. In Rev. Rul. 72-25. 1972-1 C.B. 127, and Rev. Rul. 68-99, 1968-l C.B. 193, an employee does not receive income as a result of the employer's purchase of an insurance contract to provide a source of funds for deferred compensation because the'insurance contract is the employer's asset, subject to claims of the employer's creditors.

Various revenue rulings have considered the tax consequences of nonqualified deferred compensation arrangements. Rev. Rul. 60-31, Situation l-3, 1960-l C.B. 174, holds that a mere promise to pay, not represented by notes or secured in any way, does not constitute receipt of income within the meaning of the cash receipts and disbursements method of accounting. See also, Rev. Rul. 69-650, 1969-2 C.B. 106, and Rev. Rul. 69-649, 1969-2 C.B. 106.

Under the terms of the Trust, assets will be placed in trust to be used to provide X and the adopting affiliates with a source of funds to assist in providing deferred compensation benefits to the Participants. As described above, the trustee will establish separate bookkeeping accounts to account for the contributions on behalf of X or any other subsidiary or affiliate that adopts the Plan. However, the trustee has the obligation to hold the trust assets and income in each bookkeeping account for the benefit of the general creditors of an individual employer in the event of that individual employer's insolvency. The Trust further provides that a Participant receives no beneficial ownership in or preferred claim on the trust assets. Therefore, although the assets are held in trust, in the event of an individual employer's insolvency the assets in that individual employer's bookkeeping account are fully within reach of that individual employer's general creditors, as are any other assets of the individual employer.

Section 301.7701-4(a) of the Procedure and Administration Regulations provides that, generally, an arrangement will be treated as a trust if it can be shown that the purpose of the arrangement is to vest in trustees responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility and, therefore, are not associates in a joint enterprise for the conduct of business for profit.

Section 671 of the Code provides that where a grantor shall be treated as the owner of any portion of a trust under subpart E, part I, subchapter J, chapter 1 of the Code, there shall then be included in computing the taxable income and credits of the grantor those items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust to the extent that such items would be taken into account under chapter 1 in computing taxable income or credits against tax of an individual.

Section 677(a)(2) of the Code provides that the grantor shall be treated as the owner of any portion of a trust whose income without the approval or consent of any adverse party is, or, in the discretion of the grantor or a nonadverse party, or both, may be held or accumulated for future distribution to the grantor.

Section 1.677(a)-1(d) of the regulations provides that under section 677 of the Code, a grantor is, in general, treated as the owner of a portion of a trust whose income is, or in the discretion of the grantor or a nonadverse party, or both, may be applied in discharge of a legal obligation of the grantor.

Provided (i) that creation of Trust does not cause the Plan to be other than "unfunded" for purposes of Title I of the Employee Retirement Income Security Act of 1974, (ii) that the provision of the Trust requiring use of trust assets to satisfy claims of X's general creditors in the event of X's insolvency is enforceable by such creditors under federal and state law, and (iii) the Plan and Trust are amended as proposed in your letters of July 21, 1998, and August 19, 1998 we conclude that:

1. The Trust will be classified as a trust within the meaning of section 301.7701-4(a) of the Procedure and Administration Regulations. Because the principal and income of the Trust may be applied in discharge of legal obligations of X and any adopting affiliate, X and any adopting affiliates shall be treated as the owners of the Trust under section 677 of the Code. Accordingly, there shall be included in computing the taxable income and credits of X and any adopting affiliates all items of income, deductions, and credits against tax of the Trust. Section 671.

2. Neither the creation of the Trust, the contribution of assets to the Trust, nor the crediting of earnings on the trust assets will constitute transfers of property for purposes of section 83 of the Code or section 1.83-3(e) of the regulations.

3. Neither the creation of the Trust, the contribution of assets to the Trust, nor the crediting of earnings on the trust assets will constitute a contribution to a nonexempt employees' trust under section 402(b) of the Code.

4. Under the economic benefit and constructive receipt doctrines of sections 61 and 451 of the Code, neither the adoption of the Plan, the creation of the Trust, the contributions of assets to the Trust, the crediting of earnings on the trust assets nor the deferral of compensation by a Participant in the Plan will create taxable income for the Participants or their beneficiaries under the cash receipts and disbursements method of accounting.

5. Benefits payable under the Plan and out of the Trust will be includible as compensation in the gross income of the Participants or their beneficiaries under the cash receipts and disbursements method of accounting only in the taxable year or years in which such amounts are actually distributed or otherwise made available, whichever is earlier.

6. X, or the appropriate subsidiary or other affiliate, is entitled to a deduction pursuant to section 404(a)(5) of the Code for the amounts paid or made available under the Plan in the taxable year in which such amounts are includible in the gross income of the Participants or their beneficiaries, provided such amounts otherwise meet the requirements for deductibility. However, section 280G of the Code may limit the amount that may be deducted.

Rulings 2 through 5 that relate to the Trust are based on the assumption that prior deferrals under the Plan did not result in constructive receipt of income or economic benefit. No opinion is expressed as to whether such deferrals were actually or constructively received in the prior years.

This ruling is directed only to the taxpayer who requested it. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent. Except as specifically ruled on above, no opinion is expressed as to the federal tax consequences of the transaction described above under any other provision of the Code. In particular, no opinion is expressed concerning the possible consequences of the Plan's change-in-control provisions under sections 280G and 4999 of the Code regarding the federal tax treatment of golden parachute payments, Moreover, if the Plan or Trust are substantially amended, this ruling may not remain in effect.

Sincerely yours,

ROBERT D. PATCHELL
Assistant Chief, Branch One
Office of the Associate
Chief Counsel
(Employee Benefits and
Exempt Organizations1

Enclosure:
Copy for section 6110 purposes